

Capitalization of Interest Cost
Example 2

Construction began	January 1, 2006		
	Amount	Annual interest rate	
Specific borrowing	\$ 2,500,000	6%	
Other borrowing	\$ 17,000,000	9%	
Other borrowing	\$ 28,000,000	11%	
	2006	2007	2008
Annual construction expenditures (incurred evenly during the year)	\$ 8,500,000	\$ 11,500,000	\$ 4,500,000
Facility became ready for use	May 31, 2008		
Facility started production	September 1, 2008		

Step 1: Weighted average interest rate

	Amount	Annual interest rate	
Specific borrowing	\$ 2,500,000	6%	
	Amount	Annual interest rate	Annual interest cost
Other borrowing	\$ 17,000,000	9%	\$ 1,530,000
Other borrowing	\$ 28,000,000	11%	\$ 3,080,000
Total	\$ 45,000,000	10.24%	\$ 4,610,000

Weighted average interest rate	$\$4,610,000 / \$45,000,000 = 10.24\%$
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Step 2: Average cumulative expenditures

		2006	2007	2008
A	Beginning accumulated expenditures	\$ -	\$ 4,579,278	\$ 11,281,344
B	Expenditures incurred during the year	\$ 8,500,000	\$ 11,500,000	\$ 4,500,000
C=A+B	Ending accumulated expenditures	\$ 8,500,000	\$ 16,079,278	\$ 15,781,344
D=(A+C)/2	Average accumulated expenditures	\$ 4,250,000	\$ 10,329,278	\$ 13,531,344
E	Interest cost to be capitalized	\$ 329,278	\$ 952,066	\$ 533,375
F=C+E	Accumulated expenditures after interest capitalization	\$ 4,579,278	\$ 11,281,344	\$ 14,064,719

Interest cost to be capitalized

	Borrowing amount	Interest rate	Interest cost	Number of months	Interest to be capitalized
2006	\$ 2,500,000	6%	\$ 150,000	12	\$ 329,278
	\$ 1,750,000	10.24%	\$ 179,278		
	\$ 4,250,000		\$ 329,278		
2007	\$ 2,500,000	6%	\$ 150,000	12	\$ 952,066
	\$ 7,829,278	10.24%	\$ 802,066		
	\$ 10,329,278		\$ 952,066		
2008 (January 1 - May 31)	\$ 2,500,000	6%	\$ 150,000	5	\$ 533,375
	\$ 11,031,344	10.24%	\$ 1,130,100		
	\$ 13,531,344		\$ 1,280,100		